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CABINET AFFAIRS STAFFING MEMORANDUM

Date: 1/25/84 **Number:** 168895CA **Due By:** COB 1/31/84

Subject: Farm Sector Conditions and Program Review

	Action	FYI
ALL CABINET MEMBERS	☐	☐
Vice President	☑	☐
State	☑	☐
Treasury	☐	☑
Defense	☐	☑
Attorney General	☐	☑
Interior	☑	☐
Agriculture	☑	☐
Commerce	☑	☐
Labor	☐	☑
HHS	☐	☑
HUD	☐	☑
Transportation	☑	☐
Energy	☐	☑
Education	☐	☑
Counsellor	☑	☐
OMB	☐	☑
CIA	☐	☑
UN	☐	☑
USTR	☑	☐
GSA	☐	☐
EPA	☐	☐
OPM	☐	☐
VA	☐	☐
SBA	☐	☐

	Action	FYI
CEA	☐	☑
CEQ	☐	☐
OSTP	☐	☐
________	☐	☐
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________	☐	☐
Baker	☑	☐
Deaver	☐	☑
Darman *(For WH Staffing)*	☑	☐
Jenkins	☐	☑
Mc Farlane	☐	☑
Svahn	☑	☐
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CCCT/Gunn	☐	☐
CCEA/Porter	☐	☐
CCFA/	☑	☐
CCHR/Simmons	☐	☐
CCLP/Uhlmann	☐	☐
CCMA/Bledsoe	☐	☐
CCNRE/	☐	☐

REMARKS:

Please review the attached briefing paper and provide comments to my office by COB on 1/31/84. The issue contained within this paper will be discussed in an upcoming (but not yet scheduled) Cabinet Council on Food and Agriculture meeting.

Thank you.

RETURN TO:

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THE WHITE HOUSE

WASHINGTON

January 19, 1984

MEMORANDUM FOR THE CABINET COUNCIL ON FOOD AND AGRICULTURE

FROM: JOHN R. BLOCK, CHAIRMAN PRO TEMPORE

SUBJECT: Farm Sector Conditions and Program Review

Overview

The payment-in-kind (PIK) program and the drought have reduced exessive supplies; and as a result, farm income will be increasing through 1984. We now have an opportunity to evaluate current farm policies and prepare for market-oriented programs to be implemented with the 1985 Farm Bill. However, accomplishing this objective will require a well-coordinated effort throughout the Administration. That coordinated effort must begin with an appreciation of the forces which have shaped agriculture in recent years.

Abundance and Economic Stagnation Yield Surpluses and Increasing Government Costs

Following the 1980 drought, U.S. farmers responded by planting much of their acreage. The weather cooperated and we had successive record harvests in 1981 and 1982. In just 10 years, production had jumped more than a third. Total acreage planted to major crops increased in the 1970s as demand for U.S. farm products rose and exports surged. Crop yields also increased and helped boost production.

Record production was not matched by similar increases in demand. The recession weakened domestic demand for agricultural products, particularly livestock products and raw materials. Three years of generally good weather worldwide reduced export demand for U.S. agricultural products, and strong competition from other suppliers hurt the U.S. export share as the total export market shrank. Global recession weakened income growth and demand. A dramatic slowing of capital and credit flows, together with the worldwide economic recession, left many nations in precarious cashflow and foreign exchange positions. Sharply higher interest rates not only slowed investment and demand but also increased the costs of holding commodity inventories above working needs. The higher value of the U.S. dollar made our agricultural products much more costly to foreign buyers.

With foreign demand falling, we found ourselves in late 1982 with burdensome stocks of grains, oilseeds and cotton relative to current and near-term prospective demand. Prices of these commodities were low, and in real terms farm income was dropping. Low prices and incomes caught many farmers in a severe cashflow bind, especially those who were heavily leveraged. The number of debt repayment delinquencies, bankruptcies, and foreclosures rose sharply. The demand for land slackened, leading in 1982 to the first decline in land values in more than twenty years. Declining land values reduced the equity position of farmers, thus reducing their ability to continue to borrow. Farmers' purchases of goods and services from the nonfarm sector declined, leading to financial difficulties for farm suppliers, rural merchants and businesses, and rural governments.

This was not the economic environment envisioned when the 1981 Farm Bill was developed. Thus, the commodity programs mandated by the 1981 Farm Bill quickly became part of the problem. Target prices for the major program commodities escalated between 4 to 5 percent per year while production costs stabilized or declined. The resulting spread between sagging market prices and the escalating targets was not only increasing the incentives to produce but also increasing budget exposure dramatically.

The problems were not confined to the grains sector. Surpluses and budget problems were plaguing the dairy industry; yet producers and their leaders continued to resist changes in the basic dairy program. With the basic dairy support price well above market clearing levels, declining feed costs, coupled with continued improvements in output per cow, were further aggravating the problem of surplus milk supplies. The Federal Government was required to purchase more and more dairy products to support the excessive dairy price support levels with annual costs in excess of $2 billion.

As a result of all this, total budget outlays by the Commodity Credit Corporation (CCC) soared. Net CCC outlays, which had totaled $4 billion in FY 81, reached nearly $12 billion in FY 82. Indications were that FY 83 outlays could exceed $20 billion. If actions were not taken soon to reduce the building surpluses, the prospects suggested budget outlays of $10 to $13 billion per year for the 1984-86 period.

The Payment-In-Kind (PIK) Program - Realization of Objectives

The first challenge was to take action to sharply reduce potential production and burdensome stocks, increase commodity prices and farm income, and reduce budget outlays, while preserving the natural resources that agriculture depends on for future years. On January 11, 1983, the President announced the largest acreage adjustment program in history. The PIK program has not been without its critics. However, an objective assessment must be based on the program's ability to achieve its goals. The record speaks for itself.

	U.S. Ending Stocks		Farm Prices[1]	
	1982/83	Projected 1983/84	Dec.1982	Dec.1983
Corn (mil. bushels)	3,140	595	$2.26	$3.14
Wheat "	1,509	1,441	$3.51	$3.46
Soybeans "	387	185	$5.46	$7.61
Cotton (mil. bales)	7.9	3.6	57.3¢	67.3¢
Rice (mil. cwt.)	71.5	36.9	$8.06	$8.67

1/ Farm prices are $ per bushel for wheat, corn and soybeans; cents per pound for cotton and $ per hundredweight for rice.

	1981	1982	1983	1984 (Projected)
Net Farm Income (bil. $)	30	22	22-24	29-34
Acreage in Conservation Use (mil. acres)	-	11	77	18-22
CCC Budget Outlays (bil. $)	4.0	11.6	18.8[1]	6.7

1/ This estimate does not include the book value of commodities distributed under the PIK program, which was approximately $9 billion. The outlays on these commodites were made in prior years. The loss to the Treasury is reduced potential receipts if the commodities could have been sold into the market.

While adverse weather enhanced the effectiveness of the PIK program in achieving its objectives over a shorter time frame, this does not detract from the basic success of the program. With the exception of wheat, the program has contributed to significant reductions in carryover stocks, increased prices and incomes, record acreages under conservation use, and sharply lower CCC budget outlays. And with wheat it kept the surplus from growing over 2 billion bushels.

The cost of the PIK program probably has received greater attention than any of the administrative or legal issues arising from the implementation of the program. However, the issue of costs must be dealt with in the context of the supply-demand imbalance that existed at the time of the decision to implement the PIK program.

By late 1982 it was clear that without a massive acreage reduction program, the Government was going to be taking ownership of record large quantities of commodities for which loans had already been made to farmers. Market prices were not expected to be strong enough to prevent this from happening. Moreover, the chances of market prices rising high enough to allow the Government to legally sell the commodities back on the market or to trigger release of the farmer-owned reserve were slim to none -- barring some unforeseen surge in world demand or poor weather. Thus, all the carrying costs of these record surpluses, such as storage and interest, would have been borne by the Government for a very long period of time. For example, the carrying costs per bushel of corn for just three years approached about $1.50 per bushel--about one-half of the market value. The PIK program resulted in savings of $3 billion in carrying costs to CCC through FY 1986.

- More importantly, the PIK program -- with the help of the drought -- has brought a turnaround in farm prices and the farm economy. Since the implementation of PIK, farm prices for corn have increased nearly 40 percent, cotton prices are up nearly 20 percent, and rice prices have increased around 8 percent. Wheat prices are averaging near to slightly below year earlier levels. Over the FY 83-86 period, income support (deficiency) payments are expected to be reduced by over $3.5 billion as a result of higher market prices generated by the PIK program. Moreover, over $3 billion more will be saved by lower disaster and diversion payments.

The PIK program, after adding PIK acquisition costs, is expected to reduce total Government outlays for commodity programs by about $9 billion in the period FY 1983 through FY 1986.

However, the PIK program was not without costs. The Government has given up assets (commodities) with a book value of about $9 billion that sometime in the future might have been sold back on the market with attendant reductions in Treasury borrowing. No one knows when this could have occurred legally or politically (farmers do not appreciate the Government selling commodities back on the market and depressing their prices) without a substantial reduction in production. Even if the stocks were sold, such massive sales would have depressed market prices and ultimately increased the cost of farm programs.

A related issue is the large dollar value of commodities received by individual producers. But the issue should not be whether these producers were entitled to such large payments. They were compensated in commodities for reducing acres in the same manner as every other producer -- large or small. It may be more appropriate to ask whether it is possible to have effective acreage adjustment programs without making large payments to individual farm units. Perhaps the increasing concentration of agriculture production has eroded the effectiveness of any acreage adjustment programs.

PIK was a temporary adjustment mechanism which did nothing to fundamentally change the factors that led to the large surpluses. The second challenge was to adjust the Government program incentives that were encouraging more production than the marketplace needed. It would be necessary to stop the escalation in target prices and to lower price support levels if agricultural production was to be responsive to market conditions. With respect to the dairy price support, it was clear that it was critical to reduce the incentives for producing milk by lowering price supports.

While we were able to exercise our authority to reduce feed grains and wheat loan levels, we were not successful in getting Congress to freeze target prices. All of our legislative efforts to move the issue to a vote in the Congress were blocked by a minority in the Senate. Nevertheless, target price freeze legislation was the subject of extensive debate and discussion, and it served to focus public attention on the need to make adjustments in farm price support programs.

With respect to dairy legislation, we did not achieve everything for which we had hoped. However, the new dairy legislation will provide the first reduction in dairy price supports since 1962 and will lay the foundation for the type of flexibility that is essential in keeping farm programs in line with market developments. The dairy diversion program will be difficult to administer, but at the end of the 15-month period we will have price supports as much as $1.50 per hundredweight lower than a year earlier.

A Look to 1984-85 Economic Conditions in the Farm Sector

It seems that 1984 will be a year of further adjustments. Stronger crop prices and more modest programs with less participation most likely will lead to substantially larger seedings in 1984. Most of the acreage removed from production in 1983 will be back in production this year. Corn and cotton acreage could go up 40 percent while seedings of wheat and soybeans could rise 10 to 15 percent. Production, of course, will be influenced by weather conditions in the months ahead. With generally fair conditions, crop production will surge and likely exceed the expected slow increase in use. Foreign output likely also will rise again in response to last year's higher prices.

With the exception of wheat, carryover stocks will be pulled down sharply by the time 1984 harvests begin. Corn and soybean stocks could approach pipeline levels by next fall. So it is desirable for crop production to increase enough in 1984 to allow modest stock building of corn and soybeans.

Prospects are poor for grains in domestic and foreign use in 1984. Economies in most countries will be recovering moderately, and this should help bolster demand for U.S. farm products.

However, the dollar remains strong, and the major problems facing many developing countries will not disappear. Thus, we can expect only moderate growth in the value of U.S. exports. Export volume in 1983/84 is expected to be lower.

Domestic demand should pick up along with the increase in business activity and the decline in unemployment. This should help the demand for food and fiber. However, meat supplies will remain large in early 1984, and there will be little incentive for livestock feeders to increase production, although poultry production will probably expand. This should result in a steady but limited increase in livestock prices through much of 1984.

With lackluster demand, any large increase in crop production this year likely will be reflected in sharp increases in carryover stocks and declining farm prices in late summer and early fall. Ideal weather likely would boost stocks to burdensome levels.

While consumers may continue to enjoy only moderate increases in food prices, farmers will be faced with lower farm incomes in 1985 unless a combination of weather problems here and abroad or faster increases in general economic activity come to the rescue by the middle of next year.

Policy Outlook Through 1985

It is likely that U.S. agricultural programs through 1985 will be determined by the provisions of the 1981 Agriculture and Food Act and the 1982 Omnibus Budget Reconciliation Act. This legislation establishes minimum target prices for:

	1983	1984	1985
Corn ($/bu)	2.86	3.03	3.18
Wheat ($/bu)	4.30	4.45	4.65
Cotton ($/lb)	.76	.81	.86
Rice ($/cwt)	11.40	11.90	12.40

This legislation allows the Secretary to establish higher target prices based on changes in per acre production costs.

The minimum established loan rates and dairy support price are:

		1983	1984	1985
Corn	($/bu)	2.65	2.55	2.30
Wheat	($/bu)	3.65	3.30	3.30
Cotton	($/lb)	.55	.55	.55
Rice	($/cwt)	8.14	8.00	8.00
Soybeans	($/bu)	5.02	5.02	5.02
Dairy	($/cwt)	13.10/12.60	12.60	12.60/12.10/11.60

Current law limits the Secretary's flexibility to adjust farm programs to the current economic environment. For example, we have made great strides in reducing the rate of inflation and the rate of increase in costs of farm inputs. As a result, the legislated increases in commodity target prices have greatly exceeded the rate of increase in production costs for nearly all commodities since 1981. Yet, without a change in the law, the target prices for most agricultural commodities will continue to escalate. We will continue to seek new legislation in the coming year that would reduce the rate of increase in target prices. We believe this is necessary, because without such a change we are faced with an annual potential budget exposure of over $10 billion for farm commodity programs beyond fiscal 1984.

Planning for the Future of Food and Agriculture Programs

Authority for most Federal agriculture and related programs expires at the end of the 1985 crop year. Without enactment of new legislation, the Secretary of Agriculture will have to implement the rigid and obsolete farm legislation of the past, something that the Administration and virtually all interest groups will want to avoid. In addition to the expiration of farm legislation, the economic difficulties of the farm community and the large budget outlays for agriculture programs over the last two years have attracted unparalleled public scrutiny of agricultral polices and programs. This scrutiny will increase as Congress begins to consider new farm legislation in 1984 and 1985.

On January 5, 1984, the President announced to a group of farm leaders that he was charging the Cabinet Council on Food and Agriculture to conduct a comprehensive review and assessment of current food and agriculture programs. The President indicated that the purpose of this endeavor is to better prepare the Administration to participate in the debate on the future of Federal farm programs. The President emphasized that his Administration would be seeking information and ideas from people inside and outside of government during this comprehensive review and assessment.

In order to carry out the President's directive and to maintain the Administration's leadership role in the debate on farm programs, a Cabinet Council on Food and Agriculture working group has been established to:

- review and assess current food and farm programs;
- initiate a dialogue on the future course of food and agriculture policy with interested parties outside the Administration;
- devise a list of food and agriculture policy options;

- make recommendations to the Cabinet Council regarding the components of the Administration's 1985 Farm Bill.

The working group is called the Working Group on Future Food and Agriculture Policy and consists of representatives at the assistant secretary level or above from the Departments of Agriculture, State, Treasury, and Commerce, the Office of the U.S. Trade Representative, the Office of Management and Budget, the Council of Economic Advisors, and the White House Office of Policy Development. The Deputy Secretary of Agriculture will serve as the chairman of the Working Group. The Executive Secretary of the Cabinet Council will serve as the executive director of the Working Group.